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No. _____

SUPREME COURT OF THE UNITED STATES
OCTOBER TERM 1980

RICHARD MADSEN and
NANCY MADSEN, his
wife, for themselves
and all others
similarly situated,
Respondents,

vs.

PRUDENTIAL FEDERAL SAVINGS & LOAN
ASSOCIATION, for itself and all
others similarly situated,
Petitioner,

UTAH BANKERS ASSOCIATION,
Intervenor,

PRUDENTIAL FEDERAL SAVINGS &
LOAN ASSOCIATION,
Petitioner,

vs.

RICHARD MADSEN and NANCY MADSEN,
Respondents.

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

(1) Does an action against a federally chartered savings and loan association, framed as a state common law claim for earnings on a mortgage reserve account, present federal question jurisdiction and is it, therefore, removable on the basis:

a. that a regulation (12 C.F.R. §545.6-11(c)) adopted by the Federal Home Loan Bank Board, under the authority of the Home Owner's Loan Act of 1933, expressly preempted all state law bearing on the payment of earnings on the mortgage reserve accounts; or,

b. that adjudication of the action requires the application and interpretation of the regulation, and the analysis can only be done under federal common law.

(2) Does a federal declaratory suit, brought by a federally chartered savings and loan association under 29 U.S.C. §§2201 et seq., demonstrate a present and actual controversy, and thereby convey original jurisdiction on the district court, when it pleads, among other items, a claim that the declaratory defendants demand the payment of earnings on their mortgage reserve account with the association and that the association is not required to pay earnings by virtue of a regulation (12 C.F.R. §545.6-11(c)) adopted by the Federal Home Loan Bank Board.

LIST OF PARTIES TO PROCEEDINGS IN COURT OF APPEALS

The following were parties to the proceeding in the United States Court of Appeals for the Tenth Circuit:

Richard Madsen

Nancy Madsen

Prudential Federal Savings & Loan Association[1]

Utah Bankers Association

The Honorable Aldon J. Anderson[2]

Federal Home Loan Bank Board

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[1]Pursuant to Rule 28.1 of the Rules of the Supreme Court of the United States, Prudential Federal Savings & Loan Association represents that it does not have any parent companies or affiliates, but it does have two subsidiaries known as Wasatch Management Company and Prudential Service Corporation, and the latter entity has a subsidiary known as Olympus Capital Corporation.

[2]Judge Aldon J. Anderson was a party to the proceeding in the Court of Appeals. Prudential Federal Savings & Loan Association represents that it has filed a notice with the Clerk of this Court, pursuant to Rule 19.6 of the Rules of the Supreme Court of the United States, which reflects Prudential's belief that Judge Anderson does not have an interest in the outcome of the petition for certiorari.

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OFFICIAL REPORTS OF OPINIONS IN COURTS BELOW

This action was originally commenced in the Third Judicial District Court for Salt Lake County, State of Utah. Summary judgment was granted in favor of Prudential Federal Savings & Loan Association, and the Supreme Court of Utah reversed and remanded for further proceedings. The Supreme Court's opinion is reported at Madsen v. Prudential Federal Savings & Loan Assn., 558 P.2d 1336 (Utah 1977).

The action was later removed to the United States District Court for the District of Utah, Central Division. The District Court, in an unpublished opinion, rendered judgment in favor of Prudential Federal Savings & Loan Association. The United States Court of Appeals for the Tenth Circuit reversed, holding there was

no federal jurisdiction. The opinion of the Court of Appeals is reported at Madsen v. Prudential Federal Savings & Loan Assn., 635 F.2d 797 (10th Cir. 1980).

JURISDICTION

The judgment of the United States Court of Appeals for the Tenth Circuit was entered December 3, 1980. Prudential filed a Petition for Rehearing, which was denied by the Court in an order dated January 23, 1981. Title 28 U.S.C. § 1254(1) confers jurisdiction on this Court to review the judgment by writ of certiorari.

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS INVOLVED

The case involves Article VI, Clause 2 (the Supremacy Clause) of the Constitution of the United States. It provides:

> This Constitution, and the Laws of the United States which shall be made in Pursuance

thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Two statutes are involved. The first is 28 U.S.C. § 1441(a) (1973 and Supp. 1980). It provides:

> (a) Except as otherwise expressly provided by Act of Congress, any civil action brought in a State court of which the district courts of the United States have original jurisdiction, may be removed by the defendant or the defendants, to the district court of the United States for the district and division embracing the place where such action is pending.

The second statute is 28 U.S.C. § 1337(a) (Supp. 1980). It provides:

> (a) The district courts shall have original jurisdiction of any civil action or proceeding arising under any Act of Congress regulating commerce or protecting

> trade and commerce against restraints and monopolies: Provided, however, That the district courts shall have original jurisdiction of an action brought under section 20(11) of part I of the Interstate Commerce Act (49 U.S.C. 20(11)) or section 219 of part II of such Act (49 U.S.C 319), only if the matter in controversy for each receipt or bill of lading exceeds $10,000, exclusive of interest and costs. (Italics in original).

The case involves one regulation of the Federal Home Loan Bank Board. The pertinent portion of the regulation, 12 C.F.R. § 545.6-11 (c), provides:

> (c) Payment of interest on escrow accounts. A Federal association which makes a loan on or after June 16, 1975 on the security of a single-family dwelling occupied or to be occupied by the borrower (except such a loan for which a bona fide commitment was made before that date) shall pay interest on any escrow account maintained in connection with such a loan (1) if there is in effect a specific statutory provision or provisions of the State in which such dwelling is located by or under which State-chartered savings and loan associations, mutual savings banks and similar institutions are generally required to pay interest on such escrow accounts, and (2) at not less than the rate required to be

> paid by such State-chartered institutions but not to exceed the rate being paid by the Federal association in its regular accounts (as defined in § 526.1 of this chapter). Except as provided by contract, a Federal association shall have no obligation to pay interest on escrow accounts apart from the duties imposed by this paragraph. (Italics in original).

STATEMENT OF THE CASE

1. Factual Basis and Procedural History of the Case.

On September 21, 1964, Richard Madsen and his wife, Nancy (the "Madsens") borrowed money from Prudential Federal Savings & Loan Association ("Prudential") to purchase a home in Salt Lake County, Utah. Pursuant to the loan, the Madsens signed a trust deed which required them to pay, together with the monthly payment of principal and interest, one-twelfth of the estimated annual taxes and insurance premiums on the mortgaged property. The funds were accumulated in a "reserve or escrow account" and were used annually for the payment of taxes and in-

surance. Under the trust deed, the funds were also designated as additional security for repayment of the loan.[3]

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[3]The trust deed provided:

A. To protect the security of the deed of trust, TRUSTOR agrees:

. . . .

2. To keep the buildings . . . insured against loss by fire . . . ., and to pay the premiums therefore promptly when due . . . .

3. To pay before delinquent all taxes and assessments affecting said property . . . .

In addition to the monthly payments as provided in said note, the TRUSTOR agrees to pay to the BENEFICIARY, upon the same day each month, budget payments estimated to equal one-twelfth of the annual taxes and insurance premiums; said budget payments to be adjusted from time to time as required, and said budget payments are hereby pledged to the BENEFICIARY as additional security for the full performance of this deed of trust and the note secured hereby. The budget payments so accumulated may be withdrawn by the BENEFICIARY for the payment of taxes or insurance premiums due on the premises. The BENEFICIARY may at any time, without notice, apply said budget payments to the payment of any sums due under the terms of this deed of trust and the note secured hereby or either of them. TRUSTOR'S failure to pay said budget payments shall constitute a default under this trust.

On February 27, 1975, the Madsens[4] filed a class action against Prudential, as the sole defendant, in the Third Judicial District Court for Salt Lake County, Utah. The class action was brought on behalf of a plaintiff class composed of all Prudential's mortgagors who had trust deeds "similar or identical" to the Madsens'. The complaint alleged Prudential had breached the trust deed agreements by not paying interest on the reserve accounts; alternatively, it alleged Prudential was unjustly enriched through use of the reserve funds and it prayed for the reasonable value of the benefit received by Prudential. The complaint did not seek relief for future reserve payments.

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[4]The complaint of February 27, 1975, named only Richard Madsen as plaintiff. The amended complaint filed April 10, 1975, merely joined his wife, Nancy.

Prudential moved for summary judgment. It contended that the great majority of courts, on similar facts, had expressly held, on either a motion to dismiss the complaint or on summary judgment, that the lender, as a matter of law, has no obligation to account or pay earnings on the reserve funds.[5] In

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[5]Gibson v. First Federal Savings and Loan Association, 364 F. Supp. 614 (E.D. Mich. 1973), aff'd, 504 F.2d 826 (6th Cir. 1974); Stavrides v. Mellon National Bank, 353 F.Supp. 1072 (W.D. Pa. 1973), aff'd, 487 F.2d (3d Cir. 1973); Manchester Gardens, Inc. v. Great West Life Assurance Co., 205 F.2d 872 (D.C. Cir. 1953); Umdenstock v. American Mortgage & Investment Co., 363 F.Supp. 1375 (W.D. Ok. 1973); Zelickman v. Bell Federal Savings and Loan Assn., 1 Ill.App. 3d 621, 275 N.E. 2d 300 (1971); Brooks v. Valley National Bank ("Brooks I"), 24 Ariz. App. 484, 539 P.2d 958 (1975), vacated, Brooks v. Valley National Bank ("Brooks II"), 113 Ariz. 169, 548 P.2d 1166 (1976); Surrey Strathmore Corp. v. Dollar Savings Bank of New York, 36 N.Y. 2d 173, 366 N.Y.S. 2d 107, 325 N.E. 2d 527 (1975); Richman v. Security Savings & Loan Assn., 57 Wis. 2d 358, 204 N.W. 2d 511 (1973); Durkee v. Franklin Savings Assn., 17 Ill. App. 3d 978, 309 N.E. 2d 118 (1974); Yudkin v. Avery Fed. Sav. & Loan Assn., 507 S.W. 2d 689 (Ky.App. 1974); Annot., 50 A.L.R. 3d 697 (1973).

other cases, the borrowers were unsuccessful on such theories as breach of contract, breach of trust, unjust enrichment, fraud, truth-in-lending, antitrust, pledgor-pledgee or agency.[6]

In March, 1976, the state district court granted Prudential's motion for summary judgment. The Supreme Court of Utah, in January 1977, reversed.[7] The Court indicated that under Utah law, the essential elements of a pledge were

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[6]Kinee v. Abraham Lincoln Federal Savings & Loan Assn., 365 F.Supp. 975 (E.D.Pa. 1973); Petherbridge v. Prudential Savings & Loan Assn., 79 Cal. App. 3d 509 (1978); Kronisch v. Howard Savings Institution, 161 N.J. Super. 592, 392 A.2d 178 (1978); Tierney v. Whitestone Sav. & Loan Assn., 83 Misc. 2d 855, 373 N.Y.S. 2d 724 (1975); Tucker v. Pulaski Fed. Sav. & Loan Assn., 481 S.W.2d 725 (Ark. 1972); Cale v. American Nat'l Bank, 370 Ohio Misc. 56 (1973); Carpenter v. Suffolk Franklin Sav. Bank (Carpenter II), 346 N.E.2d 892 (Mass. 1976). Kronisch, Carpenter II and Brooks II summarize recent history of the litigation.

[7]See Madsen v. Prudential Federal Savings & Loan Association, 558 P.2d 1337 (Utah 1977).

contained in the trust deed, and that absent an agreement to the contrary, a pledgee must account to the pledgor for profits earned on the pledged property. However, a review of the opinion indicates there was a question of fact, thereby precluding summary judgment, about the existence of a pledgor-pledgee relationship between the parties. The opinion did not order Prudential to account. The case was merely remanded for further proceedings.

On October 12, 1977, after remand, the Madsens amended their complaint. The new complaint alleged an enlarged plaintiff class of all Utah borrowers against an alleged defendant class of all Utah mortgage lenders. It alleged the lenders used standardized trust deeds with language "in substance and effect" similar to the Madsens' trust deed. The causes of action in the original complaint alleging (1) breach of contract for interest and (2) unjust enrichment for benefit

received from prior use of the funds, were omitted from the second amended complaint. It alleged, instead, one new cause of action for an accounting, including claims (1) that each member of the defendant class should account to the borrowers for "profits" earned from use of the reserve funds; (2) that each member of the defendant class should account to the borrowers for the "future profits" to be earned from use of the reserve funds; (3) that each member of the defendant class should pay to the borrowers the "future profits" to be earned from use of the reserves; and (4) that each member of the defendant class pursued uniform, identical policies in administering the reserve accounts.

When the Madsens amended their complaint, Prudential promptly removed the action to the United States District Court for the District of Utah. It contended that the new relief requested by the Mad-

sens arose under and was controlled by federal law, and that the members of the defendant class were entitled to have the action heard in a federal court.[8]

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[8]Prudential contended that its removal petition was timely filed. It contended (i) that when the Madsens filed their initial complaint on February 27, 1975, federal case law then held there was no basis for federal jurisdiction over common law claims for interest on reserve funds; (ii) that the Federal Home Loan Bank Board adopted a regulation (12 C.F.R. §546.6-11(c)) on May 9, 1975, which specifically governed the terms for payment of interest on reserve funds and, therefore, the Madsens' voluntary amendment of their complaint on October 12, 1977, provided Prudential with its initial opportunity to remove; (iii) that even if the original complaint were removable, removal jurisdiction still existed because the Madsens, by amending their complaint, so changed the nature of their suit that they revised Prudential's removal rights; (iv) that Prudential could remove as the representative of all members of the defendant class newly alleged in the amended complaint; (v) that even if the state action were improvidently removed, the federal district court could properly assume jurisdiction over the interest-on-escrow controversy by pursuing the federal declaratory judgment action filed by Prudential. The federal district court held the action was timely removed. The Court of Appeals did not address the issue and it is not now before this Court.

Meanwhile, in April, 1977, Prudential had filed a separate action for declaratory relief in the United States District Court for the District of Utah. The suit sought a determination of the rights and obligations of Prudential and the Madsens under the trust deed. Prudential contended that due to the regulation (12 C.F.R. §545. 6-11(c)) adopted by the Federal Home Loan Bank Board (the "Bank Board"), Prudential did not have an obligation to pay the Madsens interest on the reserve funds. The regulation provides:

> A Federal association which makes a loan on or after June 16, 1975, on the security of a single-family dwelling occupied or to be occupied by the borrower (except such a loan for which a bona fide commitment was made before that date) shall pay interest on any escrow account maintained in connection with such a loan (1) if there is in effect a specific statutory provision or provisions of the State in which such dwelling is located by or under which the State-chartered savings and loans associations, mutual savings banks and similar institutions

> are generally required to pay interest on such escrow accounts, and (2) at not less than the rate required to be paid by such State-chartered institutions but not to exceed the rate being paid by the Federal association on the regular accounts (as defined by Section 526.1 of this chapter). Except as provided by contract, a Federal association shall have no obligation to pay interest on escrow accounts apart from the duties imposed by this paragraph. (Emphasis added).

In January, 1978, the federal district court denied the Madsens' first motion to remand, and the Utah Bankers Association, a trade association of commercial banks domiciled in Utah, intervened. In February, 1978, Prudential moved for summary judgment in the removed action. Shortly thereafter, the removed action and the declaratory action were consolidated. In September, 1978, the Bank Board filed an amicus curae brief urging its federal regulatory scheme exclusively governs lending practices of federal associations and that under its

regulation (set forth above) or under federal common law, Prudential has no obligation to pay the Madsens compensation on the reserve funds. On March 9, 1979, Prudential also moved for summary judgment in the declaratory judgment action.

On April 19, 1979, the federal district court denied the Madsens' second motion to remand and their motion to dismiss for lack of federal question jurisdiction. It granted Prudential's motions for summary judgment in each case and, for that reason, determined not to proceed with the Madsens' motion to certify the alleged plaintiff class. It granted the Utah Bankers Association's motion to strike the defendant class allegations. That same day, the Madsens appealed to the United States Court of Appeals for the Tenth Circuit.[9]

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[9]In June, 1979, the Madsens also petitioned the Court of Appeals for a writ of mandamus directing the Judge of the (Footnote[9] Continued on page 16)

On December 3, 1980, the Court of Appeals reversed and ordered the removed action remanded to state court and the declaratory action dismissed. It held there was no federal controversy disclosed on the face of the Madsens' complaint and that any federal question set forth in Prudential's declaratory complaint was defensive. Consequently, there was no federal jurisdiction in either case.

2. Basis for Federal Jurisdiction of the District Court.

Prudential contends the federal district court had jurisdiction on any one of three bases: (1) because federal law preempted state law in the regulation of

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(Footnote[9] Continued from page 15) District Court, the Honorable Aldon J. Anderson, to remand the removed action and to dismiss the declaratory judgment action for lack of federal jurisdiction. Prudential moved to dismiss the petition because its basis, lack of federal jurisdiction, was an issue already pending on the appeal. A ruling was not entered by the Court of Appeals on the petition or the motion to dismiss.

federal savings and association; (2) because the trust deed between the parties must be interpreted under federal common law rather than state law; and (3) because Prudential filed an independent federal declaratory action. Each basis for jurisdiction is discussed below.

A. Removal Jurisdiction.

Any civil action founded on a federal claim or right that is within the federal district courts' original jurisdiction, may be removed from the state court pursuant to 28 U.S.C. § 1441(a).[10] The original jurisdiction was invoked by Prudential's removal petition under 28 U.S.C. § 1337(a), which provides:

> The district courts shall have original jurisdiction of any civil action or proceeding arising under any Act of Congress regulating commerce or protecting trade and commerce against restraints and monopolies.

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10. The text of 28 U.S.C. § 1441(a) is set forth in this Petition, supra at 3.

To determine whether a suit arises under a law of the United States, the court must ascertain from the complaint whether federal law is a pivotal issue in the case, one that is basic in the determination of the conflict between the parties. The principle was fashioned by this Court in Gully v. First National Bank, 299 U.S. 109 (1936):

> To bring a case within the statute, a right or immunity created by the Constitution or laws of the United States must be an element, and an essential one, of the plaintiff's cause of action. The right or immunity must be such that it will be supported if the Constitution or laws of the United States are given one construction or effect, and defeated if they receive another. A genuine and present controversy, not merely a possible or conjectural one, must exist with a reference thereto, and the controversy must be disclosed upon the face of the complaint, unaided by the answer or by the petition for removal. 299 U.S. at 112-113. (Citations omitted).

However, the lack of any reference to federal law in the complaint is not controlling. If a plaintiff's claim

is truly based on a federal question, he may not avoid removal by an artful attempt to conceal true federal questions inherent in his complaint. A suit may be removed where the real nature of the claim asserted is federal, irrespective of whether it is so characterized. In his treatise, Professor Moore has stated the rule succinctly:

> When removal is on the basis of a federal question complications may arise because of the principle that for original jurisdiction the federal question must appear in the plaintiff's complaint well pleaded. And, where the plaintiff's claim rests on both a federal and state ground, plaintiff may pitch his suit on the state ground. But though the defendant's removal petition may not be used to change the basis of the plaintiff's choice, courts have allowed the removal petition to supplement a poorly pleaded federal question necessarily raised by the plaintiff's pleading. And this is sound, for if the plaintiff chooses or must choose a federal ground, the defendant's statutory right of removal should not be defeated by poor pleading on the part of the plaintiff, intentional or otherwise. 1A J. Moore Federal Practice ¶ 0.168

> [3.-4] at 459-460 (2d ed. 1980). (Footnotes omitted).

Wright and Miller support the conclusion:

> . . . [I]n many contexts plaintiff's claim may be one that is exclusively governed by federal law, so that the plaintiff necessarily is stating a federal cause of action, whether he chooses to articulate it in that way or not. If the only remedy available to plaintiff is federal, because of preemption or otherwise, and the state court necessarily must look to federal law in passing on the claim, the case is removable regardless of what is in the pleading. Wright, Miller and Cooper, Federal Practice and Procedure: Jurisdiction § 3722 at 567-569 (1976). (Footnote omitted).

See also Sylgab Steel & Wire Corp. v. Strickland Transportation Co., 270 F. Supp. 264, 267 (E.D.N.Y. 1967); 1A J. Moore Federal Practice ¶ 0.160 at 185-187 (2d ed. 1980).

The Madsens' claim "arises under an Act of Congress," within the meaning of the removal statute, because the Bank Board's regulation preempted the payment of interest on reserve funds and because

the court, in passing on their claim, must interpret and apply the Bank Board's regulation.

(i) Preemption.

The Home Owner's Loan Act of 1933 ("HOLA"; 12 U.S.C. §§1461 et seq.) created an entire system of federal savings and loan associations. Congress could have made federal associations subject to state law, but, instead, gave plenary authority over them to the Bank Board. 12 U.S.C §1464(a). The Bank Board, an independent agency of the United States (12 U.S.C. §1437(b)), is responsible for the "organization, incorporation, examination, operation and regulation" of all federal associations. 12 U.S.C. §1464(a). HOLA specifically gave the Bank Board wide discretion to review the prevailing commercial banking practices in all of the states and to select those practices it deemed necessary or desirable to arrive at

a uniform federal savings and loan system. 12 U.S.C. §1464(a). The imposition of conflicting and inconsistent state decisions on the management of federal associations would impinge upon the comprehensive regulatory scheme drawn by the Bank Board. It would permit a federal association to do in one state what it could not do in another, thereby precluding the uniformity which Congress clearly intended. Consequently, the regulatory control of the Bank Board leaves no room for state regulatory control. This principle of federal preemption of federal savings and loan associations' affairs is clearly stated in recent case authority.[11]

In recent years lenders have been inundated with borrowers' class actions demanding that compensation be paid on

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[11] Conference of Federal Savings & Loan Associations v. Stein, 445 U.S. 921

(Footnote[11] continued on page 23)

reserve funds and, even more burdensome, that the associations account for years or decades past when neither the Bank Board, the associations nor their borrowers anticipated accounting for profits and the reserve funds were, with the Bank Board's blessing, commingled. As noted previously, the great majority of courts expressly

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(Footnote[11] continued from page 22) (1980); First Federal Savings & Loan Assn. of Boston v. Greenwald, 591 F.2d 417 (1st Cir. 1979); Meyers v. Beverly Hills Federal Savings & Loan Assn., 499 F.2d 1145 (9th Cir. 1974); Goldman v. First Federal Savings & Loan Assn. of Wilmette, 518 F.2d 1247 (7th Cir. 1975); Murphy v. Colonial Federal Savings and Loan Assn., 388 F.2d 609 (2d Cir. 1967); Federal Savings & Loan Ins. Corp. v. Third National Bank in Nashville, 153 F.2d 678 (6th Cir.), cert. denied, 329 U.S. 718 (1946); Federal Savings and Loan Ins. Corp. v. Kearney Trust Co., 151 F.2d 720 (8th Cir. 1945); Community Federal Savings & Loan Assn. of Independence, Mo. v. Fields, 128 F.2d 705 (8th Cir. 1942); Bailey v. First Federal Savings & Loan Assn. of Ottawa, 467 F.Supp. 1139 (C.D. Ill. 1979); Glendale Federal Savings and Loan Assn. v. Fox, 459 F. Supp. 903 (C.D. Cal. 1978); Rettig v. Arlington Heights Federal Savings and Loan Assn., 405 F. Supp. 819 (N.D. Ill. 1975); City Federal Savings and Loan Assn. v. Crowley, 393 F.Supp. 644 (E.D. Wis. 1975); People v. Coast Federal Sav. & Loan Assn., 98 F.Supp. 311 (S.D. Cal. 1951).

held that the lender, as a matter of law, had no obligation to account or pay earnings on the reserve funds.[12] Nevertheless, facing that tremendous wave of litigation, the Bank Board sought to put an end to the controversy by adopting the regulation. Thereafter, under either of the two circumstances set forth in the regulation (i.e., a statute or an express contract, either of which would define a rate and manner of compensation), both the borrower and the federal association would know at the end of each year that compensation would or would not be paid, and the association could keep records and make payments accordingly. Furthermore, the Bank Board prescribed, uniformly and once and for all, that there be no implied obligation to pay interest as a matter of federal law.

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[12]See cases collected in notes 5 and 6 supra, at 8-9.

On that basis, Prudential removed. Since federal substantive law is found to be controlling by reason of federal preemption, the suit is properly removable. See, e.g., North American Phillips Corp. v. Emery Air Freight Corp., 579 F.2d 229 (2d Cir. 1978); Meyers v. Beverly Hills Federal Saving & Loan Assn., 449 F.2d 1145 (9th Cir. 1974).

(ii) Federal Common Law.

The proper adjudication of the Madsens' claim requires the application of the Bank Board's regulation. The interpretation and analysis of the regulation can only be done under federal common law. The application of federal common law to a plaintiff's cause of action is sufficient to invoke federal jurisdiction and, thus, support removal. Illinois v. City of Milwaukee, 406 U.S. 91 (1972).

The Bank Board's regulation became effective on June 16, 1975. No Utah

statute then[13] required interest on reserve funds.[14] Therefore, the only instance when a federal association in Utah could be required to pay compensation on reserve funds is if it had so contracted with the borrower and then, according to the regulation, only at a rate not exceeding the rate paid on regular accounts.

The immediate question presented here was whether Prudential had contracted to pay interest or account to the Madsens for profit on their reserve account. An evaluation of their trust deed is telling. It does not promise interest or any

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[13]On July 1, 1979, after the appeal to the Court of Appeals was filed, a newly enacted Utah statute (§§ 7-17 et seq. Utah Code Ann. (1953)), governing interest on reserve accounts, became effective. It does not bear on the merits here.

[14]Federal regulation (12 C.F.R. § 545.6-11) and Utah statute (§ 7-7-5(a)(3), Utah Code Ann. (1953)), expressly authorize the collection of the reserve funds. Utah Statutes are silent about the borrower's right to compensation on the funds.

form of compensation; it is silent. Consequently, the Madsens' claim is not based on explicit, bargained-for terms of the mortgage contract between them and Prudential. To come within the "contract" exception to the Bank Board's regulation, the Madsens contend the mere use of the word "pledge" in the trust deed implies an obligation to account under state common law.

Their theory requires, at the outset, an examination and construction of the federal regulation to determine whether implied obligations are within the meaning of the term "contract." Additional threshold federal questions are presented. The Madsens seek "compensation" and/or "profits" for the use of the reserve funds. Thus, they contend the regulation is not applicable because it only refers to the payment of "interest."

Prudential considers the distinction specious. Nevertheless, the regulation must be interpreted to determine whether "interest" encompasses the payment of "profits" or "compensation." Furthermore, suppose the profits or compensation exceed the interest rate paid by an association on regular accounts. The federal regulation must be applied to limit the rate. Hence, the Madsens' claim for (1) compensation, (2) at an undetermined rate, (3) based upon an implied contractual duty to pay, necessarily involves construction of the Bank Board's regulation to determine what is a "contract" (must it be expressed or can it be implied), whether "interest" means "any compensation", and what rate of interest must be paid.

The question then is, what is the substantive law to be applied? The answer is inescapable. The regulation does not leave it to state law to determine when

and how much compensation may be paid on reserve funds by a federal association. What contractual circumstances constitute a contract of a federal association to pay compensation and how much may be paid are, under the regulation, federal questions. The substantive law to apply could only be federal, or the regulation becomes pointless. The official comment which accompanied promulgation of the Bank Board's regulation in the Federal Register underscores this conclusion. The comment unequivocally states that the payment of interest on reserves is done "solely as a matter of federal law":

> The Federal Home Bank Board on January 24, 1975, proposed an amendment to § 545.6-11 of the rules and regulations for the Federal Savings and Loan System (12 CFR 545.6-11) for the purposes of conforming § 545.6-11 with section 10 of the Real Estate Supplement Procedures Act of 1974 (Pub. L. 93.533; December 22, 1974) and requiring Federal associations, solely as a matter of Federal Law, under certain circumstances ans subject to cer-

> tain limitations to pay interest on funds held by them in escrow accounts. (Notice of such proposed rule-making was published in the FEDERAL REGISTER on January 31, 1975 (40 FR 4646), with an invitation for interested persons to submit written comments by March 4, 1975.)
>
> On the basis of its consideration of all relevant material presented by interested persons and otherwise available, the Board hereby amends said Part 545 as proposed, except for editorial changes and certain changes to clarify that the obligation to pay interest under certain circumstances is being imposed as a matter of Federal law, by revising § 545.6-11 thereof to read as set forth below, effective June 16, 1975. 40 Fed. Reg. 20942, May 14, 1975. (Emphasis added).

A leading case, Murphy v. Colonial Federal Savings & Loan Assn., 388 F. 2d 609 (2d Cir. 1967), supports the conclusion that the issue must be resolved solely by application of federal common law and not by application of Utah law. In Murphy, the plaintiffs sought a membership list of a federal savings and loan association in order to solicit proxies for the election of directors. Although a

Bank Board regulation allowed association members to vote by proxy, it set up no solicitation procedure, and did not deal specifically with the availability of the membership list. To fill this gap in the Bank Board's regulations, the Second Circuit decided it had to look to federal common law:

> The Board's regulations . . . provide that members may vote in person or by proxy. Question naturally arises whether a member desiring to enlist the aid of others in an election is entitled to find out who they are. Such an issue, which requires a fleshing out of the Board's regulations, is one of federal law . . . This would become readily apparent if the common law of the state where the association operated denied members a right of inspection; Congress could hardly have intended that the rights of members of federal savings and loan associations to fair elections should vary with quirks of local law. 388 F.2d at 611. (Citations omitted).

On this basis, too, Prudential removed. The Madsens' claim raises issues which are matters of federal common law. Consequently, the claim arises under fed-

eral law which regulates an aspect of commerce, and it could be removed. Illinois v. City of Milwaukee, 406 U.S. 91 (1972).

B. Declaratory Judgment Jurisdiction.

Even if the state action were deemed to have been improperly removed, the federal district court properly had jurisdiction over the interest-on-escrow controversy when Prudential filed its independent declaratory judgment action under 29 U.S.C. §§2201 et seq. The complaint alleged that Prudential is a federal savings and loan association, regulated exclusively by the Bank Board pursuant to the Home Owners' Loan Act of 1933; that Prudential makes residential real estate loans which are insured and guaranteed by federal agencies; and that it is not permitted to pay interest or otherwise to account for profits realized on reserve funds paid by mortgagees except as pro-

vided by applicable federal regulations. The complaint then alleged that the Madsens had filed a class action in state court seeking interest on the reserve funds held by Prudential; that a proper resolution of the controversy requires a declaration of the rights and obligations of Prudential and the Madsens under the trust deed; and that the declaration presented a question under federal laws regulating commerce or under federal common law. Since the competing positions of the parties created an actual justiciable controversy, federal jurisdiction existed. Conference of Federal Savings and Loan Assns. v. Stein, 604 F.2d 1256 (9th Cir. 1979), aff'd, 445 U.S. 921 (1980). First Federal Savings and Loan Assn. of Boston v. Greenwald, 591 F.2d 417 (1st Cir. 1979).

REASONS FOR THE ALLOWANCE OF THE WRIT

Prudential contends the Court of Appeals erred in its decision. To con-

clude that federal jurisdiction did not exist in the removed action or in the declaratory judgment action, the Court made legal analysis which conflicts irreconcilably with the decisions of this Court and with other Courts of Appeal, and it incorrectly interpreted a regulation adopted by the Bank Board. The errors are discussed below.

1. The Court of Appeals Incorrectly Held that Federal Preemption Does Not Give Rise to Removal Jurisdiction.

The Court of Appeals held that a claim of federal preemption is purely defensive and can never give rise to removal jurisdiction. That holding is in error for at least two reasons. First, it inaccurately views the use of the preemption doctrine as a purely defensive measure and, second, it squarely conflicts with other federal case authority.

The Court of Appeals held that "preemption" arguments are always raised

as defenses to affirmative claims and, consequently, that preemption may never be an appropriate basis for the exercise of federal question jurisdiction. This conclusion, however, ignores the function of "preemption" when it identifies the source of the decisional law for a case, whether it be state or federal. An indication that the decisional law is federal because of "preemption" does not necessarily mean that the defendant has a federal law defense to the claim which is to be decided. Rather, it indicates federal law has supplanted state law and the plaintiff must recover, if at all, under federal law. The proper inquiry is whether federal or state law controls the disposition of the case, without regard to potential defenses. When the concept of preemption is put in proper perspective and applied to the cause of action raised in this case, it is apparent that the Madsens' right to recover is federal in nature. By

adopting the regulation, the Bank Board unequivocally preempted state law in the determination of when compensation will be paid and at what rate. This is not to say the regulation provides an unassailable defense to Prudential or any other federal association. Rather, it is recognition that if the Madsens are to recover, they must do so, if at all, pursuant to the terms of the regulation.

Borrowers routinely claim the lender has an obligation, arising from the requirement in the borrower's mortgage contract to pay the budget payments in the first instance, to pay compensation on the reserve funds. Unless it is recognized at the outset that federal law preempts and that the Bank Board's regulation must be applied, there never will be a case where a federal association will not have an obligation to pay interest if a state court implies such a duty. Here, then, is the risk--and it is a real one--which

Prudential must endure: if the case is remanded to state court, the Madsens contend that because the trust deed has pledge language, Prudential contracted to pay interest; then, they contend the regulation does not apply because it specifically excludes contracts; and, at that point, the regulation is inapplicable and rendered meaningless, since no judicial interpretation of the regulation will ever be made. Clearly, then, interpretation of the regulation must be done now, at the beginning of the suit, in order to give any operative effect to the regulation.

If the complaint discloses a controversy in an area where federal law preempts, a federal question is necessarily implicit in the complaint and the action may be removed. That position was followed in Johnson v. England, 356 F.2d 44

(9th Cir. 1966), cert. denied, 384 U.S. 961 (1966). There, plaintiff brought an action in state court based solely on a state created right for violation of a collective bargaining agreement, seeking only a remedy under state law. The action was removed. The district court and the Ninth Circuit Court of Appeals both upheld removal jurisdiction. They held that §301 of the Labor Management Relations Act had preempted the state law in the area of the controversy and, for that reason, a construction of the complaint compelled the conclusion that the action was brought pursuant to § 301(a), thereby arising under federal law for removal purposes. This Court declined to grant certiorari.

Two years later this Court addressed the issue in Avco Corp. v. Aero Lodge No. 735, 263 F. Supp. 177(M.D. Tenn. 1966), aff'd, F.2d 337(6th Cir. 1967),

aff'd, 390 U.S. 557 (1968). There, the employer had brought suit in state court to enforce a no-strike clause in its contract with the union. After the state court had granted an ex-parte injunction, the union removed the case to federal court. The district court denied the employer's motion to remand and dissolved the state court's injunction. This judgment was affirmed by the Court of Appeals and by this Court.

In holding that the case was properly removed, this Court began by reviewing the employer's suit and noting that federal law, specifically §301(a) Labor Management Relations Act, exclusively governed the area to the exclusion of any state law. Therefore, the claim under the collective bargaining agreement was one arising under an Act of Congress within the meaning of the removal statute. The Court expressly based its finding of original jurisdiction on 28 U.S.C. §1337, the

same basis urged here by Prudential. Avco thus agrees with Prudential's contention: when state law has been preempted by federal law, the plaintiff's right of action is purely federal and removal is permissible.

A similar result was reached by the Second Circuit Court of Appeals in North American Phillips Corp. v. Emery Air Freight Corp. 579 F.2d 229 (2d Cir. 1978). There, a shipper brought an action against an air cargo carrier for the value of lost cargo. The action was commenced in state court and based on a state claim for simple damages. The carrier removed the action on the ground the claim arose under federal law, claiming specifically that its liability was limited by federal regulations promulgated by federal regulatory agencies.

The question of removal jurisdiction was not expressly addressed by the district court. However, the Court of

Appeals raised the question on its own motion and, after reviewing the issue, concluded that federal question jurisdiction did indeed exist. It noted that Congress had created a broad, comprehensive scheme covering the interstate shipment of freight. This scheme occupied the field to the exclusion of any state law. The allegations in the shipper's complaint revealed that its claim was based upon the loss of goods during interstate transportation by the carrier, who was subject to the regulatory scheme. Consequently, from the substance of the allegations, it was clear the complaint set forth a claim arising under federal law.

The Ninth Circuit Court of Appeals has reaffirmed its position on the question in Meyers v. Beverly Hills Federal Savings and Loan Assn., 499 F.2d 1145 (9th Cir. 1974). There, plaintiff brought an action in state court against a number of federal and state savings and loan associations, challenging the

exercise of pre-payment penalty provisions. The complaint stated claims only under state law. The defendants removed the case to federal court and on a motion to remand, the district court severed the claims against the state associations and remanded them to state court. The court refused to remand the claims against the federal associations and subsequently dismissed them. The Ninth Circuit affirmed the dismissal on the ground that federal law preempted state regulation of federal savings and loan associations. To affirm the dismissal, the Court must first have been satisfied that federal question jurisdiction existed in fact.

Other courts, too, have held that if the complaint discloses a controversy in an area where federal law preempts, a federal question is necessarily implicit in the complaint and the action may be removed. See, e.g., Bailey v. First Fed

eral Savings & Loan Assn. of Ottawa, 467 F. Supp. 1139 (C.D. Ill. 1979); Teamsters Local 116 v. Fargo-Moorhead Automotbile Dealers Assn., 459 F.Supp. 558 (D.N.D. 1978); First Federal Savings & Loan Assn. of Jackson County v. First Federal Savings & Loan Assn. of Huntsville, 446 F.Supp. 210 (N.D.Ala.1978); Ashley v. Southwestern Bell Telephone Co., 410 F.Supp. 1389, 1392 (W.D.Tex. 1976) (dictum); New York v. Local 144, Hotel Services Union, 410 F.Supp. 225 (S.D.N.Y.1976); Rettig v. Arlington Heights Federal Savings & Loan Assn., 405 F.Supp. 819, 822-23 (N.D.Ill. 1975); City of New Orleans v. United Gas Pipe Line Co., 390 F.Supp. 861, 863 (E.D.La. 1974) (by implication); Gardner v. Clark Oil & Refining Corp., 383 F.Supp. 151, 152-53 (E.D.Wis. 1974) (dictum); Hayes v. C. Schmidt & Sons, 374 F.Supp. 422, 445 (E.D. Pa. 1974) (dictum); Ulichny v. General Electric Co., 309 F.Supp. 437 (N.D.N.Y. 1970); Sylgab Steel & Wire Corp. v.

Strickland Transportation Co., 270 F.Supp. 264, 269 (E.D.N.Y. 1967); Minkoff v. Scranton Frocks, Inc., 172 F.Supp. 870 (S.D.N.Y. 1959); Ingraham Co. v. Local 260, 171 F. Supp. 103 (D. Conn. 1959); Fay v. American Cystoscope Makers, 98 F. Supp. 278 (S.D.N.Y. 1951).

2. The Court of Appeals Incorrectly Held that the Need to Apply Federal Common Law to the Bank Board's Regulation Does Not Give Rise to Removal Jurisdiction.

The Court of Appeals, citing Illinois v. City of Milwaukee, 406 U.S. 91 (1972), agreed with Prudential's argument that the application of federal common law to a plaintiff's cause of action is sufficient to invoke federal jurisdiction and thus support removal. But it also noted that federal common law is not automatically applied to disputes in a field which is subject to pervasive federal regulation. To apply federal common law, the Court said, there must first be a signifi-

cant conflict between some federal policy or interest and the use of state law. It found no such conflict here. It first identified in its opinion[15] the potential area of conflict which it believed Prudential had urged on appeal: "Here, it is vigorously argued that application of state law would create a significant conflict because federal policy requires uniform nationwide standards for the handling of escrow accounts by federal savings and loan associations." Then, it answered with the following observation[16]: "This argument founders on the very language of the regulation cited to support it. Section 545.6-11(c) provides that a federal savings and loan association shall pay interest on escrow accounts if a state statute requires such payments to be made by state-chartered institu-

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[15]See the Court's opinion, 635 F.2d at 802.

[16]See the Court's opinion, 635 F.2d at 802.

tions, or if payments are required by contract. The regulation expressly anticipates that the obligation of a federal institution to pay interest on escrow accounts not only will vary from state to state, but from contract to contract."

The problem with the Court's conclusion is that it rests on an incorrect characterization of the Bank Board's regulation.[17] It is important to recall the circumstances which prompted the adoption

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[17]The Court cited the case of Johnson v. First Federal Savings & Loan Assn., 418 F. Supp. 1106, 1109 (E.D. Mich. 1976), in its opinion, at 12. It was used
(Footnote 17 continued on page 46)
(Footnote 17 continued from page 45)
as authority for the Court's conclusion that there is no federal policy requiring nationwide uniformity in the handling of reserve accounts because the regulation itself incorporates by reference state law in several jurisdictions, and allows disparate results when bargained for in express contracts. Johnson is not applicable, however, since it too focused on the wrong policy. The uniform policy behind the regulation is to limit the payment of interest to only these two conditions, and to eliminate the vexatious reserve account litigation founded on equitable or extra-contractual grounds.

of the regulation. The objective of the regulation was not to achieve uniform nationwide standards for the handling of all reserve accounts by federal association. Rather, it was designed to achieve uniformity in all cases except those two specific instances where an association already knows when and how much interest it must pay: when a state legislature requires it, or when the parties expressly agree in contract. In those two instances, the association knows it must pay and can plan and budget for the payment. Only where there is an implied obligation claimed does an association not know whether or how much it may or must pay. The policy behind the regulation is to limit the payment of interest to only these two situations and, thereby, to eliminate the claims for interest founded on implied theories or extra-contractual grounds.

Where there is an overriding interest in the need for a uniform rule of decision or where the controversy touches the basic interest of federalism, this Court has fashioned federal common law. See Illinois v. City of Milwaukee, 406 U.S. 91, 105 n. 6 (1972); Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398 (1964); Annot., 31 L.Ed. 2d 1006 (1973). Certainly, these same demands for applying federal common law are present here. There must be a cohesive, uniform interpretation of the regulation. Subjecting federal associations to conflicting, implied obligation decisions is cumbersome and inefficient, and it inevitably leads to a patchwork standard for federal associations, varying from state to state. Only the adoption of a consistent federal common law standard for the application of the regulation will fulfill the underlying objective of the statute to cure the implied obligation claims. See Gibson v.

First Federal Savings & Loan Assn., 364 F.Supp. 614 (E.D. Mich. 1973), aff'd, 504 F. 2d 826, 829 (6th Cir. 1974) ("Insofar as the Federal Home Loan Bank Board determines to regulate relationships between federal savings and loan associations and their borrowing and investing members, consideration of such regulations by federal courts is most likely to produce uniformity"). There is present, therefore, a significant conflict between the Madsens' state law claim and federal policy on interest. That significant conflict supports federal jurisdiction and, hence, removal.

3. The Court of Appeals Incorrectly Held That All Issues In Prudential's Declaratory Judgment Action Were Defensive And Could Not, Therefore, Convey Federal Jurisdiction.

The Court of Appeals held the federal issues raised in Prudential's declaratory complaint were merely affirma-

tive defenses to the removed action and were not sufficient, therefore, to convey original jurisdiction on the district court. The Court based its holding on the case of Public Service Commission of Utah v. Wycoff Co., 344 U.S. 237 (1952). In doing so, however, the Court of Appeals inappropriately applied the reasoning of the Wycoff decision. In that case, a motor carrier sought a declaratory judgment that a specific haul was interstate commerce and not subject to the regulation of the Public Service Commission of Utah. There was no proof of any threatened act by the commission which would constitute an actual controversy; rather, the carrier was only seeking to establish a defense to use if the commission sued it. This Court dismissed the action, concluding the carrier was only seeking a present declaration that it would have a good defense should the commission take action in the future.

A recent decision from the United States Court of Appeals for the First Circuit, First Federal Savings and Loan Assn. of Boston v. Greenwald, 591 F.2d 417 (1st Cir. 1979), is precisely in point, both substantially and procedurally, and it is diametrically contrary to the opinion of the Tenth Circuit Court of Appeals. On facts virtually identical to those presented here, and applying the Wycoff decision, the Court found federal jurisdiction in a federal declaratory suit.

In Greenwald, the State of Massachusetts had enacted a statute which required all mortgagees operating in the state to pay interest on their tax reserve accounts and to file informational reports concerning the accounts. Greenwald, the Massachusetts Commissioner of Banks, initiated a state declaratory action to compel every federal savings and loan association in the state to comply with the statute. First Federal, which was sued as

the representative party on behalf of the federal associations, removed the case to the federal district court on the ground it would involve the interpretation and application of federal statutes, specifically 12 C.F.R. §545.6-11, the same Bank Board regulation presented here. Greenwald's motion to remand was denied.

While the remand issue was being resolved, First Federal filed an answer which included several affirmative defenses of particular relevance here: (1) federal regulations promulgated by the Bank Board totally occupy the field of regulation of the practices and procedures of federal savings and loan associations relating to the maintenance and payment of interest on reserve accounts; and (2) those portions of the state statute which the Commissioner sought to enforce were in conflict with the federal regulations and were, therefore, inapplicable to federal associations under the Supremacy Clause.

First Federal also filed a counterclaim against the Commissioner and the Bank Board for declaratory relief to resolve the conflicting positions between the Commissioner and the Bank Board regarding First Federal's obligation to pay interest on the reserve accounts.

In addition to the counterclaim, First Federal and the other federal associations in the state instituted a separate action against the Commissioner and the Bank Board in the federal district court. The new action paralleled the First Federal counterclaim in the removed suit and sought an adjudication under the Declaratory Judgment Act (28 U.S.C. §§2201, 2202) of the conflicting positions of the Commissioner and the Bank Board. The two actions were consolidated for hearing in the district court.

Each party in Greenwald moved for summary judgment. The district court in each case granted First Federal's and the

Bank Board's motions for summary judgment and denied the Commissioner's. It held that the state statute violated the Supremacy clause when applied to federally-chartered savings and loan associations because (1) federal law had preempted the field of compensation on reserve accounts by federal associations, and (2) the state statute directly conflicted with 12 C.F.R. §545.6-11. The Court of Appeals affirmed the decision. It held that the state statute, as applied to federal associations, actually conflicted with 12 C.F.R. §545.6-11(c) and, therefore, was preempted.

The opinion is significant in this case for its discussion of the propriety of the removal. On appeal, the Commissioner argued in part that the federal district court erred in refusing to remand to the state court because it lacked subject matter jurisdiction over the removed action. The Court of Appeals rejected the argument. It noted that the

district court had based removal jurisdiction over the Commissioner's state action on the ground that it arose under federal law: federal law had preempted the area of the payment of interest on real extate tax escrow accounts. But the Court of Appeals did not pass on this determination because it held that the district court could decide the merits of the controversy on the basis of the associations' federal declaratory judgment action:

> . . . [E]ven if removal of the Commissioner's action were improper, the district court clearly had jurisdiction over the associations' separate declaratory judgment action which involved the same issues and was consolidated with the Commissioner's action for hearing and decision. The matter of preemption and related federal issues were the focal point of the declaratory judgment suit, hence federal question jurisdiction existed in that case under any analysis. 591 F.2d at 423.

Then, on the question of jurisdiction, the Court held:

> The associations' declaratory judgment action raises more than a mere defense to the Commissioner's action. See generally Public Service Comm'n v. Wycoff Co., 344 U.S. 237, 248, 73 S.Ct. 236, 97 L.Ed. 291 (1952). Both the state and federal regulations are currently in effect, subjecting the associations to conflicting requirements . . . which would have presented a justiciable controversy even if the declaratory suit had been brought prior to the Commissoner's enforcement act, Lake Carriers' Ass'n v. MacMullan, 406 U.S. 498, 506-08, 92 S.Ct. 1749, 32 L.Ed 2d 257 (1972). It therefore has a vitality of its own and may be maintained. Rath Packing Co. v. Becker, 530 F.2d 1295, 1305-06 (9th Cir. 1975), aff'd sub nom Jones v. Rath Packing Co., 430 U.S. 519, 97 S.Ct. 1305, 51 L.ed. 2d 604 (1977). 591 F.2d at 423, n. 8.

The suit raised more than a mere federal defense to the contemporaneously removed action between the same parties, since the declaratory plaintiff was currently subjected to conflicting legal requirements and the declaratory suit provided a forum for resolution of the conflict. The same is true here. Prudential's declaratory action raises more than

a mere defense; it presents a present and genuine controversy over the parties' rights and duties under the Bank Board's regulation. The Madsens demand compensation; Prudential cannot pay under the regulation. The Madsens' argue the Supreme Court of Utah ordered Prudential to pay compensation on the reserve accounts. If true, that decision and the Bank Board's regulation would then subject Prudential to conflicting requirements. That conflict alone presents a justiciable controversy - precisely as in Greenwald - and provides jurisdiction.

This Court recently affirmed an identical conclusion reached by the United States Court of Appeals for the Ninth Circuit in Conference of Federal Savings and Loan Assns. v. Stein, 604 F.2d 1256 (9th Cir. 1979), aff'd, 445 U.S. 921 (1980). In that case, the State of California enacted an act designed to regulate "redlining" practices of mortgage lenders in

the state. After passage of the act, Stein, the State's Secretary of the Business and Transportation Agency, notified all lending institutions operating in California, including federal savings and loan associations, that they would be required to abide by the provisions of the act. The Federal Home Loan Bank Board responded with an opinion that the state act did not apply to federal associations.

The Conference of Federal Savings and Loan Associations, joined by several federal associations, commenced a federal declaratory suit against Stein and the Bank Board. They sought a declaration that the act was preempted by the Home Owner's Loan Act of 1933 and by regulations adopted by the Bank Board. The Bank Board, in turn, filed a cross claim against Stein, seeking to enjoin him from enforcing the act against federal associations. Stein responded by bringing an independent suit against West Coast Feder-

al Savings and Loan Association, charging it with violations of the state act and seeking statutory damages.

The federal district court held Stein did not have the power to regulate federal associations under the act. It determined that the regulatory authority of the Bank Board, under the HOLA, pre-empted state regulation.

Stein appealed, contending the district court did not have jurisdiction because there was no federal question. Citing Wycoff, he offered the same argument made by the Court of Appeals in this case: that preemption is only a federal defense to a potential state claim. The Ninth Circuit flatly disagreed:

> [Wycoff] is distinguishable, however. There, the majority concluded that there was no proof of any threatened or probable act by the state commission which might cause the irreparable injury essential to equitable relief or which could serve to create the actual controversy necessary for declaratory judgment jurisdiction. Here, an

> actual conflict exists created by the conflicting positions taken by [Stein] and the Bank Board. See First Federal Savings and Loan Ass'n of Boston v. Greenwald, 591 F.2d 417, 423 n. 8 (1st Cir. 1979).
>
> > "Both the state and federal regulations are currently in effect, subjecting the associations to conflicting requirements . . ."
>
> An actual justiciable controversy is thus presented. 604 F.2d at 1259.

As noted above, an actual controversy between adversary parties is presented here, too. The declaratory action affords a procedure for its resolution. Jurisdiction existed, therefore.

CONTENTS OF APPENDIX

The Appendix contains the following documents, in order:

(i) A copy of the opinion rendered by the United States Court of Appeals for the Tenth Circuit. (Appendix A).

(ii) A copy of the Order entered by the United States District Court for the District of Utah. (Appendix B).

(iii) A copy of the Judgment entered by the United States District Court for the District of Utah in the removed action. (Appendix C).

(iv) A copy of the Judgment entered by the United States District Court for the District of Utah in the declaratory judgment suit. (Appendix D).

(v) A copy of the opinion rendered by the Supreme Court of Utah. (Appendix E).

(vi) A copy of the Order on Rehearing, entered by the United States Court of Appeals for the Tenth Circuit. (Appendix F).

CONCLUSION

The petition for writ of certiorari should be granted.

DATED this 10th day of April, 1981.

MOYLE & DRAPER

By _____
Joseph J. Palmer

By _____
Reid E. Lewis
600 Deseret Plaza
Salt Lake City, Utah 84111
Attorneys for Petitioner
Prudential Federal
Savings & Loan
Association

CERTIFICATE OF SERVICE

I, Reid E. Lewis, hereby certify that on the 10th day of April, 1981, I deposited three (3) copies of the Petition for Writ of Certiorari in a United States mailbox, with first-class postage prepaid, addressed to each of the following:

Honorable Aldon J. Anderson
United States District Judge
350 South Main Street
Salt Lake City, Utah 84101

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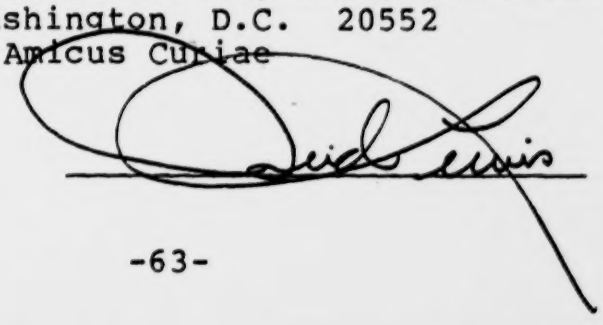

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

Richard MADSEN and Nancy Madsen, his wife, for themselves and all others similarly situated, Plaintiffs-Appellants,

v.

PRUDENTIAL FEDERAL SAVINGS & LOAN ASSOCIATION, for itself and all others similarly situated, Defendant-Appellee,

Utah Bankers Association,
Intervenor-Appellee.

Richard MADSEN and Nancy Madsen, for themselves and all others similarly situated, Petitioners,

v.

Honorable Aldon J. ANDERSON, Judge of the United States District Court for the District of Utah, Central Division, Respondent.

Nos. 79-1362, 79-1535

Decided December 3, 1980

Rehearing Denied January 23, 1981

Before LOGAN, PECK* and SEYMOUR, Circuit Judges.

SEYMOUR, Circuit Judge.

The Madsens, plaintiffs-appellants, borrowed money from Prudential Federal Savings

*Of the United States Court of Appeals for the Sixth Circuit sitting by designation.

& Loan Association (Prudential) to purchase a home in 1964. Pursuant to this loan, the Madsens signed a trust deed[1] requiring them to make "budget payments" of one-twelfth of the annual estimated taxes and insurance along with their monthly payments of principal and interest. Under the agreement, these budget payments were pledged as additional security for repayment of the loan.

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[1]The trust deed provides in pertinent part:

> "In addition to the monthly payments as provided in said note, the TRUSTOR agrees to pay to the BENEFICIARY, upon the same day each month, budget payments estimated to equal one-twelfth of the annual taxes and insurance premiums; said budget payments to be adjusted from time to time as required, and said budget payments are hereby pledged to the BENEFICIARY as additional security for the full performance of this deed of trust and the note secured hereby. The budget payments so accumulated may be withdrawn by the BENEFICIARY for the payment of taxes or insurance premiums due on the premises. The BENEFICIARY may at any time, without notice, apply said budget payments to the payment of sums due under the terms of this deed of trust and the note secured hereby or either of them. TRUSTOR'S failure to pay said budget payments shall constitute a default under this trust."

App., vol. I, at 5.

The funds were accumulated in a reserve account and used annually for the payment of taxes and insurance.

On March 3, 1975, the Madsens[2] filed a class action[3] in Utah state court seeking to recover interest realized from Prudential's use of the escrowed funds, based on claims of breach of contract and unjust enrichment. The state trial court granted Prudential's motion for summary judgment. In January 1977, the Utah Supreme Court reversed the summary judgment and remanded for further proceedings. It held that the trust deed contained the essential elements of a pledge, and that under Utah common law a pledgee must account to the pledgor for profits resulting from the use of the pledged property. In October

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[2]The original complaint named Richard Madsen only as plaintiff. An amended complaint was filed April 10, 1975, joining his wife Nancy.

[3]Numerous issues regarding the classes named in these proceedings have been raised on appeal. They are not relevant to our disposition of this case and are not addressed in our opinion.

1977, the Madsens amended their complaint to ask for an accounting and recovery of the profits earned by Prudential on the escrowed amounts. This amended complaint added a defendant class of lenders with similar escrow arrangements.

Meanwhile in April 1977, Prudential filed a separate action for declaratory relief in federal court, asserting that under 12 C.F.R. §545.6-11(c)[4] (hereinafter

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[4]12 C.F.R. §545.6-11(c) provides:

> "A Federal association which makes a loan on or after June 16, 1975, on the security of a single-family dwelling occupied or to be occupied by the borrower (except such a loan for which a bona fide commitment was made before that date) shall pay interest on any escrow account maintained in connection with such a loan (1) if there is in effect a specific statutory provision or provisions of the State in which such dwelling is located by or under which the State-chartered savings and loan associations, mutual savings banks and similar institutions are generally required to pay interest on such escrow accounts, and (2) at not less than the rate required to be paid by such State-chartered institutions but not to exceed the rate being paid by the Federal association on its regular accounts (as defined by Section 526.1 of this chapter). Except as provided by contract, a Federal association shall have no obligation to pay interest on escrow accounts apart from the duties imposed by this paragraph." (Emphasis added).

referred to as section 545.6-11(c)), it is not required to pay interest or account to the Madsens on the escrowed funds. The complaint based jurisdiction on 28 U.S.C. § 1337[5] and sought a declaration of the rights and obligations of the parties to the trust deed. When the Madsens amended their state complaint, Prudential promptly filed a removal petition, alleging that the relief requested arises under and is controlled by federal law. The Utah Bankers Association, a trade association of commercial banks domiciled in Utah, intervened in the action, and the Federal Home Loan Bank Board filed an amicus curiae brief. The federal court denied the Madsens' motion to remand the case, consolidated the removed action and the declaratory judgment suit,

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[5]28 U.S.C. § 1337 provides:

> "The district courts shall have original jurisdiction of any civil action or proceeding arising under any Act of Congress regulating commerce or protecting trade and commerce against restraints and monopolies."

and granted summary judgment in favor of Prudential.

On appeal, the Madsens contend, inter alia, that the federal court lacks jurisdiction over either the removed case or the declaratory judgment action. We agree, and reverse with directions to remand the removed action to state court and to dismiss the declaratory action.

I.

Removal Jurisdiction

Prudential sought removal pursuant to 28 U.S.C. § 1441(b), which provides in pertinent part:

> "Any civil action of which the district courts have original jurisdiction founded on a claim or right arising under the Constitution, treaties or laws of the United States shall be removable without regard to the citizenship or residence of the parties."

Jurisdiction was claimed under 28 U.S.C.

§ 1331[6] and section 1337 because the cause of action allegedly arose under the laws of the United States and Acts of Congress regulating commerce.

The Madsens contend their claim in state court is founded upon contract rights and obligations created by state law. They assert that Prudential retains the Madsens' budget payments for up to a year before using the funds to pay the taxes and insurance, that Prudential invests the funds in the interim and receives a profit, and that the Madsens are entitled to be paid the profits earned on the pledged funds. The Madsens point out that no federal law or regulation was invoked, relied on, attacked,

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[6]28 U.S.C. §1331(a) provides in pertinent part:

> "The district courts shall have original jurisdiction of all civil actions wherein the matter in controversy exceeds the sum or value of $10,000, exclusive of interest and costs, and arises under the Constitution, laws or treaties of the United States."

We note that the same standards apply to whether the issue "arises under" federal law in both this section and section 1337.

or cited in their complaint. Consequently, they say, their claim did not arise under federal law.

Prudential and Intervenor argue, on the other hand, that the trust agreement between Prudential and the Madsens contains no express language requiring the payment of interest on the escrowed funds, and that the federal regulation does not contemplate interest payments under such circumstances. They say that interpretation of the agreement arises under federal law because Prudential is a regulated federal savings and loan association and Congress has preempted the area.

The conditions under which a suit may be said to "arise under" the laws of the United States were definitively set out in Gully v. First National Bank, 299 U.S. 109, 57 S.Ct. 96, 81 L.Ed. 70 (1936). There the Court stated that the required federal right or immunity must be an essential element of the plaintiff's cause of action, and that

the federal controversy must be "disclosed upon the face of the complaint, unaided by the answer or by the petition for removal." Id. at 113, 57 S.Ct. at 98. It is beyond argument that a defense predicated upon federal law is not enough by itself to confer federal jurisdiction, even though the defense is certain to arise. Pan American Petroleum Corp. v. Superior Court, 366 U.S. 656, 663, 81 S.Ct. 1303, 1307, 6 L.Ed.2d 584 (1961); Seneca Nursing Home v. Kansas State Board of Social Welfare, 490 F.2d 1324, 1328 (10th Cir. 1974), cert. denied, 419 U.S. 841, 95 S.Ct. 72, 42 L.Ed.2d 69 (1974); Warner Bros. Records, Inc. v. R. A. Ridges Distributing Co., 475 F.2d 262 (10th Cir. 1973).

In Mountain Fuel Supply Co. v. Johnson, 586 F.2d 1375, 1381 (10th Cir. 1978), cert. denied, 441 U.S. 952, 99 S.Ct. 2182, 60 L.Ed.2d 1058 (1979), we described the test for determining whether a complaint asserts,

on its face, a substantial federal question:

> "A case 'arises' under the laws of the United States if it clearly and substantially involves a dispute or controversy respecting the validity, construction or effect of such laws which is determinative of the resulting judgment. Shulthis v. McDougal, 225 U.S. 561, 32 S.Ct. 704, 56 L.Ed. 1205 (1912). Thus, if the action is not expressly authorized by federal law, does not require the construction of a federal statute and/or regulation and is not required by some distinctive policy of a federal statute to be determined by application of federal legal principles, it does not arise under the laws of the United States for federal question jurisdiction. Lindy v. Lynn, 501 F.2d 1367 (3rd Cir. 1974)."

No argument has been made on appeal that the Madsens' claim is expressly authorized by federal law. Consequently, federal removal jurisdiction is established in this case only if the Madsens' claim requires the construction of a federal regulation or the application of federal law.

The federal trial court based its finding of jurisdiction on North Davis Bank v. First National Bank, 457 F.2d 820 (10th Cir. 1972). We find that case distinguishable. There the central issue in the complaint

was whether the defendant's facility constituted a branch of a national bank. We noted that the Supreme Court in First National Bank v. Dickinson, 396 U.S. 122, 133, 90 S.Ct. 337, 343, 24 L.Ed.2d 312 (1969), held this determination to be a "threshold question of federal law." 457 F.2d at 822. Therefore we held: "[t]his is not a case in which a federal statute is indirectly or collaterally involved but it is one having its source in and arising under [the McFadden Act] 12 U.S.C. § 36(f)." Id. at 823.

Here the basic issue in the Madsens' complaint is whether the contract between the Madsens and Prudential requires the payment of profits or interest on escrowed funds. Although construction of the federal regulation cited by Prudential may be relevant to the defense Prudential asserts, i.e., that section 545.6-11(c) does not require payment of interest, the meaning of the regulation is absolutely irrelevant to the Madsens' theory of

recovery. Because the Madsens have predicated their suit upon rights created under state law, the fact that federal regulations may create a defense to recovery on such a claim is immaterial to a finding of federal question jurisdiction. See Phillips Petroleum Co. v. Texaco, 415 U.S. 125, 94 S.Ct. 1002, 39 L.Ed.2d 209 (1974); Pan American Petroleum, 366 U.S. at 662-64, 81 S.Ct. at 1307-1308.

Prudential and Intervenor contend that removal jurisdiction exists because federal law has preempted state law in the area of federal savings and loan regulation. The amicus curiae brief supports the argument that the field of regulatory control over federal associations has been preempted. However, even if federal preemption were established, it would not confer jurisdiction when it is raised by the defendant to defeat a common-law contract claim brought in state court. See Pan American Petroleum, 366 U.S. at 662-65, 81 S.Ct.

at 1307-1309; Washington v. American League of Professional Baseball Clubs, 460 F.2d 654, 660 (9th Cir. 1972), and cases cited therein. In Home Federal Savings & Loan Association v. Insurance Department, 571 F.2d 423 (8th Cir. 1978), the court dismissed the case for lack of subject matter jurisdiction despite a federal preemption argument:

> "[T]he Commissioner's proceeding against Home Federal was based solely upon alleged violations of Iowa's insurance law and raised no federal question. Home Federal's allegations of preemption and failure to engage in the 'business of insurance,' asserted in its federal petition, actually are in the nature of defenses to the Commissioner's charges. Hence they will not suffice for federal question jurisdiction here. The case is basically simply an alleged violation of state law. It is not a federal case and is not converted to one by Home Federal's defenses to the state's basic allegations."

Id. at 427. Prudential's claim of federal preemption is in the nature of a defense to the Madsens' cause of action and cannot be the basis of federal question jurisdiction on removal.

It is also argued that the Madsens' claim arises under the laws of the United States because the contract must be interpreted under federal common law rather than state law. This is so, Prudential urges, because the regulation addressing the payment of interest by federal savings and loan associations, section 545.6-11(c), states that "[e]xcept as provided by contract, a Federal Association shall have no obligation to pay interest on escrow accounts apart from the duties imposed by this paragraph." (Emphasis added). Prudential contends that the circumstances constituting a "contract" within the meaning of the federal regulation is a federal question.

It is true that the application of federal common law to a plaintiff's cause of action is sufficient to invoke federal jurisdiction and thus support removal. See Illinois v. Milwaukee, 406 U.S. 91, 100, 92 S.Ct. 1385, 1391, 31 L.Ed.2d 712 (1972).

However, federal common law is not automatically applied to resolve all disputes in a field subject to pervasive federal regulation. "In deciding whether rules of federal common law should be fashioned, normally the guiding principle is that a significant conflict between some federal policy or interest and the use of state law in the premises must first be specifically shown." Wallis v. Pan American Petroleum Corp., 384 U.S. 63, 68, 86 S.Ct. 1301, 1304, 16 L.Ed.2d 369 (1966). Here, it is vigorously argued that application of state law would create a significant conflict because federal policy requires uniform nationwide standards for the handling of escrow accounts by federal savings and loan associations. This argument founders on the very language of the regulation cited to support it. Section 545.6-11(c) provides that a federal savings and loan association shall pay interest on escrow accounts if a state statute requires such payments to

be made by state-chartered institutions, or if payments are required by contract. The regulation expressly anticipates that the obligation of a federal institution to pay interest on escrow accounts not only will vary from state to state, but from contract to contract. See Johnson v. First Federal Savings & Loan Association, 418 F.Supp. 1106, 1109 (E.D.Mich. 1976). Any argument that federal policy requires nationwide uniformity with regard to this issue is untenable.[7] See United States v. Yazell, 382 U.S. 341, 86 S.Ct. 500, 15 L.Ed.2d 404 (1966).

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[7]We note Intervenor's argument that this case arises under federal law because the mortgage form must be approved by the regulatory agency, see 24 C.F.R. §203.17, and because the mortgage must provide for monthly escrow payments for taxes and insurance, see 24 C.F.R. § 203.23(a). However, these regulations are silent on the issue of interest payments on escrow accounts, and therefore do not conflict with section 545.6-11(c), which allows interest to be required or prohibited by the individual contract terms. Accordingly, we reject the argument that the use of these forms mandates a uniform interpretation under federal law.

Contractual obligations are created by state law. See Gully, 299 U.S. at 114-15, 57 S.Ct. at 98-99. See also Pan American Petroleum v. Superior Court, 366 U.S. at 662-663, 81 S.Ct. at 1307-1308. "The interpretation and enforcement of contracts is [sic] traditionally within the province of state courts," Mariniello v. Shell Oil Co., 511 F.2d 853, 858 (3d Cir. 1975), and the general presumption is in favor of applying state law. Note: Federal Common Law, 82 Harv.L.Rev. 1512 (1969). Given the absence of a significant conflict between the federal policy expressed in section 545.6-11(c) and the use of state law, we hold that state law is applicable in determining whether Prudential contracted to pay interest on the Madsens' escrow account.

Since no federal controversy was disclosed on the face of the Madsens' state court complaint, as amended, removal was improper and the consolidated case must be remanded to state court.

II.

Declaratory Judgment Jurisdiction

The question remains whether the federal court has subject matter jurisdiction over Prudential's declaratory judgment action. The federal complaint alleges that Prudential is a federal savings and loan association regulated by the Federal Home Loan Bank Board, that it makes residential real estate loans insured and guaranteed by federal agencies, and that it is not permitted to pay interest or to otherwise account for profits realized on escrowed funds paid by mortgagors "except as provided by applicable federal regulations." App., vol. II, at 180. It points out that the Madsens have filed a class action in state court seeking interest on the escrowed funds under the contractual arrangements between Prudential and its borrowers, that "[a] proper resolution of said controversy requires a declaration of the respective rights and obligations of the parties to

said contractual arrangements," id. at 181, and that this determination presents a question under federal laws regulating commerce or under federal common law.[8]

As we have noted, the federal regulation that Prudential cites in its complaint provides that interest shall be paid on escrow accounts if a statute in the state whether the mortgaged property is located requires similar lending institutions to pay such interest. 12 C.F.R. 545.6-11(c), supra n. 4. The regulation also provides that a federal association has no other obligation to pay such interest "[e]xcept as provided by contract." Id. Consequently, the controversy underlying the federal declaratory judgment action is the same as in state court: whether Prudential is obligated by its contract with the Madsens to pay interest on the escrowed funds.

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[8]We have already concluded in part I, supra, that federal common law is not applicable to interpret the contract between Prudential and the Madsens.

This court has consistently adopted the rationale set out by the Supreme Court in Public Service Commission of Utah v. Wycoff Co., 344 U.S. 237, 248, 73 S.Ct. 236, 242-243, 97 L.Ed. 291 (1952):

> "Where the complaint in an action for declaratory judgment seeks in essence to assert a defense to an impending or threatened state court action, it is the character of the threatened action, and not of the defense, which will determine whether there is federal-question jurisdiction in the District Court. If the cause of action, which the declaratory defendant threatens to assert, does not itself involve a claim under federal law, it is doubtful if a federal court may entertain an action for a declaratory judgment establishing a defense to that claim. This is dubious even though the declaratory complaint sets forth a claim of federal right, if that right is in reality in the nature of a defense to a threatened cause of action. Federal courts will not seize litigations from state courts merely because one, normally a defendant, goes to federal court to begin his federal-law defense before the state court begins the case under state law. (citations omitted)."

(Emphasis added). In Monks v. Hetherington, 573 F.2d 1164, 1167 (10th Cir. 1978), we applied the traditional view "that a party cannot by artful pleading anticipate a defense based on federal law and thus bring

within federal jurisdiction an action that could not otherwise be heard in federal court." And in Chandler v. O'Bryan, 445 F.2d 1045, 1055-56 (10th Cir. 1971), we noted that this principle is particularly applicable where, as here, the state court action has been instituted and issues have been decided.

We held in part I, supra, that the federal preemption argument is defensive in nature. This is true whether the claim is made as the basis of removal or to support federal jurisdiction in a declaratory judgment action. See, e.g., Home Federal Savings & Loan Association v. Insurance Department, 571 F.2d 423 (8th Cir. 1978). This case is not like Conference of Federal Savings & Loan Associations v. Stein, 604 F.2d 1256 (9th Cir. 1979), aff'd mem., 445 U.S. 921, 100 S.Ct. 1304, 63 L.Ed.2d 754 (1980), First Federal Savings & Loan Association v. Greenwald, 591 F.2d 417 (1st Cir. 1979), or others cited by Prudential, Intervenor,

and amicus curiae, where state regulations directly conflict with federal regulations governing federal associations. No such conflict exists here.

The defensive nature of Prudential's claim is expressed throughout its complaint. It alleges that a state action has been brought seeking interest pursuant to the contractual arrangements between the parties, and that any order of the state court requiring Prudential to pay interest or otherwise account to the Madsens would be contrary to the federal regulations. If the Madsens had attempted to bring their action in federal court by anticipating or responding to Prudential's possible federal defense, the case would lack federal jurisdiction. See Phillips Petroleum, 415 U.S. at 128, 94 S.Ct. at 1004; Skelly Oil Co., 339 U.S. 667, at 672, 70 S.Ct. 876, 879, 94 L.Ed. 1194; Home Federal Savings & Loan Association, 571 F.2d at 426-27. It is irrelevant for purposes of jurisdiction that

"federal consent is the source of state authority." Gully, 299 U.S. at 116, 57 S.Ct. at 99; Oklahoma ex rel. Wilson v. Blankenship, 447 F.2d 687, 691 (10th Cir)., cert. denied, 405 U.S. 918, 92 S.Ct. 942, 30 L.Ed.2d 787 (1971).

Here as in Gully "[t]he most one can say is that a question of federal law is lurking in the background." 299 U.S. at 117, 57 S.Ct. at 99-100. Accordingly, we hold the court has no jurisdiction over the declaratory judgment complaint and the actions must be dismissed.

Reversed.

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF UTAH, CENTRAL DIVISION

RICHARD MADSEN and NANCY MADSEN, his wife, for themselves and all others similarly situated,	)	
Plaintiffs,	)	C 77-0350
v.	)	
PRUDENTIAL FEDERAL SAVINGS & LOAN ASSOCIATION, for itself and all others similarly situated,	)	
Defendants.	)	
UTAH BANKERS ASSOCIATION,	)	ORDER
Intervenor.	)	

PRUDENTIAL FEDERAL SAVINGS & LOAN ASSOCIATION,	)	
Plaintiff,	)	
v.	)	C 77-0111
RICHARD MADSEN and NANCY MADSEN,	)	
Defendants.	)	

APPENDIX B

The above-entitled actions came before the court on April 6 and 9, 1979, for hearing on various motions. The court, having considered the memoranda of counsel and their oral arguments, enters the following order:

(1) Madsens' motion to remand in C 77-0350 is denied. Federal question jurisdiction is present in this action by virtue of 12 C.F.R. § 545.6-11(c) and the rule of North Davis Bank v. First National Bank of Layton, 457 F.2d 820 (10th Cir. 1972) (action is removable if "directly concerned with the construction of federal law and a determination of rights thereunder"). The action was timely removed in that Prudential filed a petition for removal on behalf of the defendant class within thirty days after October 12, 1977, the date when Madsens were granted leave to amend their complaint to allege a defendant class. Prudential was entitled

to remove on behalf of the defendant class without regard to the probability or improbability of eventual certification of the defendant class.

(2) Madsens' motion to dismiss for lack of federal question jurisdiction in C 77-0350 is denied. Important federal questions remain in this action. Madsens' reliance on res judicata is inappropriate. Res Judicata does not prevent this court from considering federal issues that were previously ignored by the state courts in the course of this litigation. No subsequent lawsuit is involved here. This is simply a later stage of the same lawsuit that was before the state courts.

(3) The Federal Home Loan Bank Board's motion for leave to file an amicus brief is granted. The Board's brief, which was filed with the court on September 21, 1978, is received.

(4) Madsens' motion to continue disposition of Prudential's motion to dismiss or motion for summary judgment pending determination of class issues is denied. For reasons stated below, the court is persuaded that Madsens' claim against Prudential is wholly without merit. Since it is manifest that they cannot succeed on the merits, it is unnecessary to proceed to class certification before resolving the controversy on the merits.

(5) Prudential's motions for summary judgment in both cases are granted. Under the federal preemption doctrine, Madsens have no claim against Prudential for interest on their escrow account. 12 C.F.R. § 545.6-11(c) clearly precludes the relief the Madsens are seeking. That regulation is not subject to attack under the theory that it retroactively abrogates vested rights. There is no assurance that, under state law, Madsens at any time had any

kind of right, much less an inviolable vested right, to receive interest on the escrow funds. More importantly, the regulation cited above does not appear to alter the federal law applicable to loans made before June 16, 1975, but instead appears to reaffirm the impact of 12 C.F.R. §§ 544.1 ("association is not required to distribute earnings on short-term savings accounts") and 541.5 (defining short-term savings account as including mortgage loan escrow accounts for taxes and insurance).

(6) Intervenor's motion to strike defendant class allegations is granted. Under the holdings of La Mar v. H & B Novelty & Loan Co., 489 F.2d 461 (9th Cir. 1973) and Weiner v. Bank of King of Prussia, 358 F. Supp. 684 (E.D. Pa. 1973), the Madsens lack standing to sue defendants other than Prudential and cannot, as a matter of law, satisfy the Rule 23(a) requirements of typicality and adequate representation.

Moreover, it appears to the court that certification of the defendant class would be futile in any event because of the great probability that defendant class members would take advantage of the "opting out" provisions of Rule 23(c).

The conspiracy and juridical relationship exceptions to the La Mar and Weiner doctrines are not applicable in this case. No conspiracy or juridical relationship among defendants has been pleaded or shown to exist. The vague allegation of an industrywide practice provides insufficient basis for finding a juridical relationship. Moreover, the lending institutions in question operate under diverse bodies of law and distinctly separate regulatory agencies.

(7) Madsens' motion to maintain plaintiff and defendant classes is denied. The defendant class cannot be maintained for the reasons stated above with respect to the motion to strike class allegations and

for the further reason that a defendant class action does not appear to be superior to other available methods for the fair and efficient adjudication of the controversy. Since the defendant class cannot be maintained, neither can the plaintiff class survive except for those who are Prudential borrowers. Since those persons clearly have no cause of action, it serves no useful purpose to certify a class of Prudential borrowers. The court is persuaded that no class certification is now in effect. The certification order entered by the state court was nullified by the amendment of Madsens' complaint to allege a vastly broader class of plaintiffs.

(8) Madsens' motion to give notice to class members and motion for leave to communicate with citizens committee are denied.

(9) All other motions pending in these actions are dismissed as moot.

For the reasons stated herein and for the further reasons stated by the court on the record on April 6 and 9, 1979,

IT IS SO ORDERED.

DATED this 19th day of April, 1979.

/s/ ALDON J. ANDERSON
United States District Judge

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF UTAH, CENTRAL DIVISION

RICHARD MADSEN and NANCY MADSEN, his wife, for themselves and all others similarly situated,	)	JUDGMENT
Plaintiffs,	)	
v.	)	C 77-0350
PRUDENTIAL FEDERAL SAVINGS & LOAN ASSOCIATION, for itself and all others similarly situated,	)	
Defendants.	)	
UTAH BANKERS ASSOCIATION,	)	
Intervenor.	)	

For the reasons stated in the court's order dated April 19, 1979,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that this action is dismissed with prejudice, plaintiffs having no cause of action against defendants.

APPENDIX C

DATED this 19th day of April, 1979.

/s/ ALDON J. ANDERSON
United States District Judge

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF UTAH, CENTRAL DIVISION

PRUDENTIAL FEDERAL SAVINGS & LOAN ASSOCIATION,	)	
Plaintiff,	)	JUDGMENT
v.	)	C 77-0111
RICHARD MADSEN and NANCY MADSEN,	)	
Defendants.	)	

For the reasons stated in the court's order dated April 19, 1979, the court

HEREBY ORDERS, ADJUDGES, AND DECLARES the rights of the parties as follows: Under applicable federal law, plaintiff has no obligation to pay and cannot be compelled to pay interest or otherwise account to defendants for the net earnings on funds held by plaintiff in defendants' mortgage loan escrow account.

APPENDIX D

DATED this 19th day of April, 1979.

/s/ ALDON J. ANDERSON
United States District
Judge

Supreme Court of Utah.

Richard MADSEN and Nancy A. Madsen,
his wife, Plaintiffs and Appellants,

v.

PRUDENTIAL FEDERAL SAVINGS &
LOAN ASSOCIATION, Defendant
and Respondent.

No. 14530.

Decided Jan. 14, 1977.

MAUGHAN, Justice:

On appeal is a summary judgment granted to defendant, hereafter Prudential, against plaintiffs, hereafter Madsen or trustors. The action is founded upon terms of a deed of trust; and was brought to determine the status of the parties, and the legal consequences pursuant to such terms. We reverse the summary judgment, and remand for further proceedings. Costs are awarded to Madsen. Statutory references are to U.C.A. 1953.

Madsens are trustors, and defendant is both the trustee and beneficiary under a deed of trust executed September 21, 1964,

for the purpose of securing a promissory note in the sum of $16,800. The security conveyed was the home in which plaintiffs reside.

To protect the security, the trustors further agreed:

> 2. To keep the buildings and improvements on the above described premises insured against loss by fire, and such other casualties and in such forms of insurance, and in such amounts, and in such companies as may be required by and as may be satisfactory to the beneficiary, for the benefit of the beneficiary, and to pay the premiums therefor promptly when due, and the policies of insurance shall be held by the beneficiary, it being understood, however, that the beneficiary shall in no event be responsible for the sufficiency or form or substance of any policy of insurance, or for the solvency or sufficiency of any insurance company in respect to the insurance herein provided.
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> . . . . . .
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> 4. To pay before delinquent all taxes and assessments affecting said property (including assessments on appurtenant water stock and costs, interest and penalties thereon); and all encumbrances, charges and liens, with interest and penalties on said property or any part thereof, which appear to be or are prior or superior hereto.

> In addition to the monthly payments as provided in said note, the trustor agrees to pay to the beneficiary, upon the same day each month, budget payments estimated to equal one-twelfth of the annual taxes and insurance premiums; said budget payments to be adjusted from time to time as required, and said budget payments are hereby pledged to the beneficiary as additional security for the full performance of this deed of trust and the note secured hereby. The budget payments so accumulated may be withdrawn by the beneficiary for the payment of taxes or insurance premiums due on the premises. The beneficiary may at any time, without notice, apply said budget payments to the payment of any sums due under the terms of the deed of trust and the note secured hereby or either of them. Trustor's failure to pay said budget payments shall constitute a default under this trust. [Emphasis supplied.]

Madsen's appeal is predicated on the theory that the monthly budget payments under provision 4 of the instrument constitute a common law pledge. They alleged defendant had invested this pledged property, and earned a substantial profit. An accounting is sought on the ground the substantial profits from the investment of the pledged funds constitute an unjust

enrichment, entitling them to restitution.

The trial court ruled the funds accumulated, from the monthly budget payments, were not pledged property. Therefore, the law of pledge was not applicable.

In Campbell v. Peter[1] this court stated:

> A pledge is really one of the simplest forms of security. It is the passing of possession of a chattel by the owner thereof to the pledgee who is thereby entitled to hold it until the debt is paid or the obligation performed. [Citations]

We further cited with approval the definition in the Restatement Security, Sec. 1, p. 5, which provides:

> A pledge is a security interest in a chattel or an intangible represented by an indispensable instrument, the interest being created by a bailment for the purpose of securing the payment of a debt or the performance of some other duty.

Comment d. of Sec. 1, p. 10 states:

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1. 108 Utah 565, 568, 162 P.2d 754, 755 (1945).

> The term "chattel" means any physical object which is capable of manual delivery and which is not the subject-matter of real property. It includes instruments and documents.

A deposit of money as security for the performance of a contract has been recognized as a valid pledge.[2]

> . . . it [is] of no consequence that the amount of funds subjected to the lien, and thus, the amount of the lien, may vary during the existence of the pledge. The amount is ascertainable at any given time, and thus the lien is perfected as to amount.[3]

In the current matter, plaintiffs, as the trustors, agreed to protect the security of Prudential by paying the insurance and taxes. Madsen agreed to pay the budget payments, and to pledge them to the beneficiary "as additional security for the full performance" of the deed of trust and the note secured thereby.

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2. Anderson v. Pacific Bank. 112 Cal. 598, 44 P. 1063 (1896); United States v. Harris, USDC WD La.1966, 249 F. Supp. 221, 224; 68 Am.Jur.2d, Secured Transactions, Sec. 58, pp. 886-887.

3. United States v. Harris, note 2 supra.

The essential elements of a pledge are contained in the agreement, viz., the existence of a debt or obligation, a transfer of property to the pledgee, to be held as security and, if necessary, to be used to assure performance of the obligation. Furthermore, the payments accumulated, may, in the discretion of the beneficiary, be withdrawn for the payment of taxes, insurance premiums due, or any sum due under the deed of trust, or note. There is no contract right granted to Madsen to compel defendant to pay the insurance premiums or taxes. The payments accumulated may be retained as security or applied for the purposes stated. The primary obligation to pay the insurance, taxes, and any sum due under the deed of trust or note is Madsen's. The provisions of section 4 grant a security interest to Prudential, for the purpose of securing performance of trustors' obligations.

Madsen cites Hoyt v. Upper Marion Ditch Company[4] to establish the legal consequences, under a common law pledge, wherein profits accrue to pledgee; as a result of the possession of a pledged chattel. We there said it is the duty of a pledgee to collect the accruals, from the security, and apply them to the debt. We there explained: when the property pledged is of such a character as not to be lessened by use, the pledgee does not incur liability by using it; but, if from the use of it profits are derived, pledgee must, in the absence of a special agreement, account for them to the pledgor. There cited as authority was 21 R.C.L. 665-666, Sec. 28; the relevant provisions of which are:

> . . . If from the use of the property pledged profits are derived, the pledgee must in the absence of a special agreement to the contrary account therefor to the pledgor, and

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4. 94 Utah 134, 143, 76 P.2d 234 (1938).

> apply the net proceeds of such use to the extinction of the debt. So if any profits accrue from property held as collateral, such profits, while they may be collected and retained by the pledgee, must be credited to the pledgor, or applied to the sum due from him, as where dividends accrue on pledged stock, or interest is collected on a security held as collateral.[5]

The foregoing principles of the law of pledge are not new. Indeed, Madsen's counsel cites the Code of Manu and that of Hammurabi, for early examples.[6] These principles have not been discarded. In our Uniform Commercial Code we find:

> Unless otherwise agreed, when collateral is in the secured party's possession
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> . . . . . .
>
> (c) the secured party may hold as additional security any increase or profits (except money) received from the collateral, but money so received, unless remitted to the debtor, shall be applied in

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5. See 69 Am.Jur.2d Secured Transactions, § 223, pp. 58-59.

6. I. A. Rocureck and J. S. Wigmore, Source of Ancient and Primitve Law, p. 401 (1915).

> reduction of the secured obligation; . . ..[7]

An excursus to 9-207, of the Uniform Commercial Code, illuminates the provision:[8]

> 2. Subsection (2) states rules, which follow common law precedents, and which apply, unless there is agreement otherwise, in typical situations during the period while the secured party is in possession of the collateral.

This principle is also set forth in the Restatement, Security, Sec. 27, p. 91:

> The pledgee has the duty to account to the pledgor for the increase or profits accruing to the pledgee as a result of the possession of the pledged chattel.

ELLETT and WILKINS, JJ., concur.

CROCKETT, Justice (dissenting).

I have no disagreement with the general proposition advocated by the plaintiffs, and as set forth in the main opinion, that

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7. 70A-9-207(2), U.C.A., 1953.

8. 3 ULA, Uniform Commercial Code (Master Edition) § 9-207 p. 123.

where there is a simple pledge of property, which can be put to profitable use without lessening its value, and the pledgee uses it for a profit, the profit should inure to the benefit of the pledgor, unless the understanding of the parties is to the contrary. It is not my understanding that the position of the defendant or of the trial court is in disagreement therewith. That position briefly stated is this: That it is shown that both the plaintiffs and the defendant were fully aware of the manner in which this so-called monthly "budget payment" of one-twelfth of the taxes and insurance for the year was to be made and handled to insure payments of those essentials; that even though plaintiffs were so aware and considered this to be unfair, they did not then so state, nor make any request that interest should be paid thereon, but voluntarily entered into the contract fully and

clearly setting forth the rights and obligations of the parties, but without the contract containing any such covenant as to the payment of interest.

There are some elementary principles of contract law that should be given consideration here: that when parties negotiate on a subject matter and reduce their agreement to writing, it should be presumed to consolidate their entire understanding as to mutual rights and obligations on that subject matter;[1] and further, that the contract should be enforced and enforceable against each party only in accordance with the covenants expressed therein.[2]

Pertinent to the plaintiffs' demand for payment of interest on the "budget payment" it is to be noted that the documentary

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1. Mawhinney v. Jensen, 120 Utah 142, 232 P.2d 769.

2. See Jones v. Acme Bldg. Products, 22 Utah 2d 202, 450 P.2d 743.

evidence shows that over the years of their contract that account had an average balance of $275.42, which at an interest rate of 5% would produce $13.70 per year; and that the estimated cost to the bank of the collecting, accounting and disbursing of such "budget payments" would be $16 + per account per year.

When all of the foregoing is considered in the light of the principles of law set forth above, I think the trial court was justified in adopting the position essayed by the defendant: that if the plaintiffs had desired a covenant to pay interest on the "budget payment" they should have so stated and negotiated for such a covenant in the contract. But having failed to do so, they should not be permitted to stand by and make these payments for 11 years without expressing any expectation or making any demand for interest thereon, and then attempt to impose a new obligation

upon the defendant, not provided for in the contract.

I would affirm the judgment, leaving the parties to their rights as expressed in the covenants of the contract as made, or as may be made in the future with respect to interest on such payments.

HENRIOD, C. J., concurs in the views expressed in the dissenting opinion of CROCKETT, J.

NOVEMBER TERM - January 23, 1981

Before Honorable Oliver Seth, Honorable William J. Holloway, Jr., Honorable Robert H. McWilliams, Honorable James E. Barrett, Honorable William E. Doyle, Honorable Monroe G. McKay, Honorable James K. Logan, Honorable Stephanie K. Seymour and Honorable John W. Peck*, Circuit Judges.

RICHARD MADSEN and NANCY MADSEN, his wife for themselves and all others similarly situated,	)	
Plaintiffs-Appellants,	)	
v.	)	No. 79-1362
PRUDENTIAL FEDERAL SAVINGS & LOAN ASSOCIATION, for itself and all others similarly situated,	)	
Defendant-Appellee,	)	
UTAH BANKERS ASSOCIATION,	)	
Intervenor,	)	
FEDERAL HOME LOAN BANK BOARD,	)	
Amicus Curiae.	)	
RICHARD MADSEN and NANCY MADSEN, his wife, for themselves and all others similarly situated,	)	
Petitioners,	)	No. 79-1535

APPENDIX F

v.)
)
HONORABLE ALDON J. ANDER-)
SON, Judge of the United)
States District Court for)
the District of Utah,)
Central Division,)
)
Respondent.)

This matter comes on for consideration of appellees' petition for rehearing and suggestion for rehearing en banc in the captioned causes.

Upon consideration whereof, the petition for rehearing is denied by the panel to whom the cases were argued and submitted.

The petition for rehearing having been denied by the panel to whom the cases were argued and submitted, and no member of the panel nor judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, Rule 35, Federal Rules of Appellate Procedure, the suggestion for rehearing en banc is denied.

HOWARD K. PHILLIPS, Clerk

By: /s/ Robert L. Hoecker
Chief Deputy Clerk

*Of the United States Circuit Court for the Sixth Circuit, sitting by designation.